STATE OF MICHIGAN

IN THE SUPREME COURT

DETROIT EDISON COMPANY,

Plaintiff-Appellee,

v

Supreme Court No.148753

Court of Appeals No. 309732

Court of Claims No. 10-104-MT

DEPARTMENT OF TREASURY,
STATE OF MICHIGAN,

Defendant-Appellant.

_____/

AMICUS CURIAE BRIEF OF INTERNATIONAL TRANSMISSION COMPANY IN SUPPORT OF PETITIONER-APPELLEE DETROIT EDISON COMPANY

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TABLE OF CONTENTS

Page(s)

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

OTHER AUTHORITIES

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STATEMENT OF INTEREST

International Transmission Company (d/b/a ITC*Transmission*) ("ITC*Transmission*") is a wholly-owned subsidiary of ITC Holdings Corp., the nation's largest independent electricity transmission company. ITC*Transmission*, which is based in Novi, Michigan, owns, operates and maintains approximately 2,800 circuit miles of transmission line in southeast Michigan, serving a population of 5.1 million. In connection with its electric transmission business, ITC*Transmission* has obtained, and possesses, substantial experience and expertise related to electric transmission.

As the record in this case confirms, before electricity becomes a final consumer product, it is subject to continued processing during the three integrated phases by which electricity is provided to customers: generation, transmission, and distribution. As an independent transmission company, ITC*Transmission* is focused solely on this second phase, which is comprised of the activities and processing that are necessary to provide for the transmission of electricity. ITC*Transmission* does not generate or distribute electricity. ITC*Transmission* is an industrial processor, and its transmission activities are necessary industrial processing activities that must be completed before electricity becomes a final product that can be sold to consumers.

Since the Legislature partially deregulated the electricity markets in Michigan in 2000, ITC*Transmission* has provided transmission services through the use of an extensive collection of transmission equipment, including all equipment necessary to change and monitor voltage, quality, and character of the electricity as it is processed through the transmission phase of the integrated electric system for ultimate sale to customers at retail by Detroit Edison and other electric utilities. ITC*Transmission's* transmission activities are regulated by state and federal government agencies, including the Michigan Public Service Commission (the "MPSC") and the

Federal Energy Regulatory Commission. Regulating agencies mandate that the processing required in the transmission of electricity be conducted in a responsible, safe and economical manner. Under state law, MPSC Orders, and this Court's prior precedent, the costs of providing transmission services, including the use tax costs at issue in the instant litigation, are includible in costs that are recoverable in electricity rates that are charged to customers and subject to sales tax. *See Attorney General v Michigan Public Service Commission (In re Detroit Edison Co),* 483 Mich 993 (2009). If the Department were to prevail and asses use taxes on the purchase and use of transmission assets, ITC*Transmission's* payment of those taxes would be passed directly to consumers and subject to sales tax.

This case raises issues of great importance to ITC*Transmission*, and to the State of Michigan and its businesses and citizens who consume electricity. For ITC*Transmission*, it is critical to provide input because the potential reversal of the well-reasoned decision of the Court of Appeals would threaten to treat the transmission phase of the electric system as other than an industrial process, to pyramid sales and use tax, and to unduly increase the cost of electricity to consumers.

For these reasons, as set forth in more detail below, ITC*Transmission* asks this Court to affirm the Court of Appeals' decision, which held that industrial processing occurs after electricity leaves the generation phase of the integrated electric system and that statutory industrial processing activities must be conducted during transmission so that electricity can ultimately become a finished consumer good for sale at retail. In connection with this request, ITC*Transmission* seeks a ruling from this Court to confirm that the transmission of electricity, in and of itself, constitutes industrial processing, and that the pyramiding of sales and use taxes on sales of electricity at issue in this case is both unlawful and against public policy. Any potential

reversal of this decision threatens to unsettle what now should be settled law in Michigan, to depart from scientific evidence provided in this case, and to expose electricity consumers in Michigan and electric utilities to substantial uncertainty with respect to the manner in which—and the number of times—regulated electric utilities and electricity consumers will be taxed on a single retail sale of electricity.

STATEMENT OF FACTS

ITC*Transmission* agrees with and adopts the Statement of Facts set forth in the brief filed by Petitioner-Appellee Detroit Edison Company. Before electricity becomes a final consumer product, it is subject to continued processing during the three integrated phases by which electricity is provided to customers. The voltage and current levels of electricity are drastically changed at multiple times throughout this process, and electricity is not in a form usable by the customer until it reaches the customer's meter. In fact, the in-process electricity can be very dangerous. Various equipment is used throughout this integrated process in order to convert, change, control, monitor, and test the electricity. The total cost of generation, transmission, and distribution—including the cost of the equipment used in these processes —is included in electricity rates used to compute electricity charges that are subject to Michigan sales tax in full at the time the electricity is sold to the end consumer.

ARGUMENT

A. During the Transmission Phase of the Integrated Electric Process, Continuous Industrial Processing Activities Must Take Place Before Electricity Can Be Converted and Placed in a Form that Is Safe and Usable by Consumers.

The extensive record in this case confirms that before electricity reaches consumers, it must be processed through an integrated, three-phase electric system that involves generation, transmission, and distribution. The transmission phase begins when a transmission company

accepts the in-process electricity from a generation plant transformer. The transmission company processes the high-voltage electricity through multiple substations, transformers, and related equipment and ultimately transmits the in-process electricity to a distribution company transformer after transmission is completed. Transmission activities, in and of themselves, constitute industrial processing[1] under Michigan law and the transmission company is an industrial processor.[2] Once the transmission process is finished, additional processing is conducted in the distribution phase as the electricity is converted to lower voltage levels and the electricity is ultimately placed in a form that is suitable for ultimate sale to consumers. At all times during the transmission process (and distribution process, until the electricity is converted to safe, retail voltage levels and reaches the final customer's meter), electricity is being processed at voltage levels that render the electricity unsafe and unusable by nearly all consumers. In fact, the transmission process requires that electricity be stepped up and down in stages by converting the electricity through the use of transformers until the electricity reaches voltage levels that are safe to begin the distribution process.[3] Transmission activities specifically involve industrial processing because form composition, quality, combination, or character of

[1]MCL 205.94o(7)(a) ("'industrial processing' means the activity of converting or conditioning tangible personal property by changing the form, composition, quality, combination, or character of the property for ultimate sale at retail.")

[2]MCL 205.94o(7)(b) ("'industrial processor' means a person who performs the activity of converting [*i.e.*, transforming (see The Random House Dictionary of The English Language, P. 444 (2nd ed. 1987).] or conditioning tangible personal property (*i.e.*, electricity (MCL 205.92(k)) for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail.")

[3]As properly stated by the Court of Appeals, "[v]oltage levels at a generation plant range somewhere from 15,000 to 25,000 volts, while standard usable levels are from 120 to 240 volts, with some industrial customers running as much as 480 volts, " and that "[t]here is no dispute that once electricity leaves a generation plant, the voltage must be both increased to allow for transmission and decreased to allow for use, which increase and decreases are accomplished through the use of the machinery and equipment at issue." Court of Appeals Opinion, p. 2.

electricity, which is statutorily defined to be tangible personal property,[4] is being changed as the voltage, frequency, and other characteristics of electricity are changed as the in-process electricity is converted into a final, retail product. As noted by the Court of Appeals, "[a]s [electricity] moves through the [e]lectric [s]ystem, the characteristics of electricity continue to change as the [e]lectric [s]ystem experiences load changes (electricity demand), faults and switching spikes . . . after electricity passes through a customer's meter, the electricity becomes a finished good and is sold to the end user as a retail product." Court of Appeals Opinion, pp. 2-3.

As indicated in detail in the brief filed by Plaintiff-Appellee, under the plain language of applicable law, tangible personal property purchased for use in industrial processing activities is exempt from use tax. Specifically relevant to the transmission of electricity, Michigan law provides that "industrial processing" includes the following activities:

(a) Production or assembly

(b) Research or experimental activities

(c) *Engineering related to industrial processing*

(d) *Inspection, qualify control, or testing to determine whether particular units of materials or products or processes conform to specified parameter at any time before materials or products come to rest in finished goods inventory storage*.

(e) *Planning, scheduling, supervision, or control of production or other exempt activities*.

(f) Design, construction, or maintenance of production or other exempt machinery, equipment, or tooling.

[4]MCL 205.92k (use tax); MCL 205.51a(q) (sales tax).

(g) Remanufacturing

(h) Processing of production scrap and waste up to the point it is stored for removal from the plant of origin.

(i) Recycling of used materials for ultimate sale at retail or reuse

(j) Production material handling

(k) Storage of in-process materials.

MCL 205.94(t) (emphasis added).

As the record in this case confirms, it is indisputable that transmission requires specific industrial processing activities to be conducted continuously as high-voltage electricity is stepped up and down in voltage and converted to a form that it is safe for distribution. Transmission necessarily involves engineering related to the processing and conversion of electricity as it is transmitted and before it enters distribution transformers.[5] Transmission requires comprehensive inspection, quality control, and testing of electricity to determine whether particular units of electricity conform to specified, safe parameters throughout the entire transmission process.[6] Transmission requires comprehensive computerized planning, scheduling, supervision and control of the electricity conversion and transmission process.[7] And transmission requires specialized equipment and computers to ensure that production material handling is completed in a safe and reliable manner.[8]

Transmission activities begin with the acceptance of high-voltage electricity from a generation level transformer. The high-voltage electricity exits a generation transformer and is accepted into a transmission company's network where various processing actions take place;

[5] *See* MCL 205.94o(3)(c).
[6] *See* MCL 205.94o(3)(d).
[7] *See* MCL 205.94o(3)(e).
[8] *See* MCL 205.94o(3)(j).

the transmission process often requires stepping up and/or down the voltage while the electricity is monitored and tested to provide for quality control and to ensure that each unit of electricity, measured in megawatts or kilowatts, conforms to specified parameters throughout the process.[9] Throughout the transmission process, computerized equipment is conducting planning, scheduling, and supervision of the electricity transmission process, and is monitoring and controlling the voltage level and quality of the in-process electricity.[10] In summary, throughout the transmission phase of the integrated electric process, specific statutory industrial processing activities must be conducted as the electricity is processed and changed in its form, composition, quality, combination, or character[11] before the electricity leaves the last transmission transformer and enters the distribution phase. During the transmission of electricity, electricity is not a final retail product until it is delivered to the customer's meter. The equipment used in the electricity transmission process is at all times used in industrial processing, and the cost of all such equipment is included in electricity rates that are used to compute the amounts charged to consumers – amounts that are subject to Michigan sales tax in full on electricity bills. No costs are excluded from the Michigan sales tax base.

B. Sales and Use Taxes Are Interrelated and Complementary.

As indicated above, the full cost of electricity, including generation, transmission, and distribution costs, are included in the rates that are used to compute the amounts charged to consumers for electricity, and these amounts are subject in full to Michigan sales tax. Moreover, under Michigan law, sales tax and use tax are designed to be supplementary and complementary such that once sales tax applies, no use tax should be imposed on the same transaction. *Elias*

[9] *See* Court of Appeals Opinion, p. 10.

[10] *Id.*

[11] The terms "form, composition, quality, combination, or character are sufficiently broad and expansive to encompass voltage and current changes of electricity as it travels through the transmission and distribution system." Court of Appeals Opinion, p. 10.

Bros Restaurants v Treasury Dep't, 452 Mich 144, 153; 549 NW2d 837 (1996). Sales tax is imposed on the gross proceeds (*i.e.*, gross retail sales) of a business. *GMC v Dep't of Treasury*, 466 Mich 231, 237; 644 NW2d 734 (2002). Under the General Sales Tax Act, "there is levied upon and there shall be collected from all persons engaged in the business of making sales at retail, by which ownership of tangible personal property is transferred for consideration, an annual tax for the privilege of engaging in that business equal to 6% of the gross proceeds of the business." MCL 205.52(1). Although the sales tax is imposed on the seller, "the seller may pass it on to the purchaser and collect it at the point of sale." *World Book, Inc v Revenue Div*, 459 Mich 403, 408; 590 NW2d 293 (1999).

Similarly, the Use Tax Act levies and assesses a tax "for the privilege of using, storing, or consuming tangible personal property in this state at a rate equal to 6% of the price of the property." MCL 205.93(1). The use tax complements the sales tax in that the use tax is levied on transactions involving transfers of tangible personal property to which the sales tax does not apply. Both the sales tax and the use tax are imposed at an identical, six percent rate and the two taxes are designed to work together and complement one another such that a single six percent tax is paid on the purchase and use or consumption of tangible personal property in Michigan, while avoiding the imposition of both use and sales tax on the same property. *Granger v Dep't of Treasury*, 286 Mich App 601, 608; 780 NW2d 611 (2009); *WMS Gaming, Inc v Dep't of Treasury*, 274 Mich App 440, 442-443; 733 NW2d 97 (2007) (explaining how use tax is imposed on the use of property that is purchased out-of-state and imported into Michigan for use, as it is not subject to Michigan sales tax); *Don McCullagh, Inc v Dep't of Revenue*, 354 Mich 413, 424; 93 NW2d 252 (1958) ("[I]t is apparent that the legislature in the enactment of the sales

tax act and use tax act, and numerous amendments thereto, has sought to avoid the burden of both taxes being imposed on the same business transaction.").

C. The Department Seeks to Unlawfully Pyramid Taxes By Imposing Use Tax on Property Necessary to Create a Final Retail Product and Imposing Sales Tax on the Full Retail Sales Price of the Same Final Product.

In determining the retail price of finished goods, sellers consider their production costs, including the costs of equipment used to create those finished, retail goods, and pass those total costs along to the consumer in a retail sale; the consumer pays sales tax based on the retail price. The Legislature recognized this and in enacting the Use Tax Act, it "sought to avoid multiple layers of taxation—referred to as pyramiding—by exempting property used or consumed in the production of goods that will ultimately be subject to a use or sales tax when purchased by consumers." *Granger*, 286 Mich App at 614-615, citing *Elias Bros*, 452 Mich at 152.

To avoid the multiple taxation caused by pyramiding, a sale of property to an "industrial processor for use or consumption in industrial processing" is exempt from Michigan's use tax. MCL 205.94o(1)(a). The industrial processing exemption precludes the taxation of inputs used to create a final retail product. As this Court has explained: "The industrial processing exemption is, in part, the product of a targeted legislative effort to avoid double taxation of the end product offered for retail sale or, in other terms, to avoid 'pyramiding the use and sales tax.' Pyramiding occurs when both use and sales taxes are imposed on the production and sale of retail goods." *Elias Bros*, 452 Mich at 152. As the Senate Fiscal Agency explained, "If the end product is taxed, the components used or consumed in its production are not taxed so that the product is not subject to double taxation." *Id.*, quoting Senate Fiscal Agency Analysis, SB 323, June 2, 1987.

Under MCL 205.52(2)(a), sales tax specifically applies to "[t]he transmission and distribution of electricity . . . if the sale is made to the consumer or user of the electricity for

consumption or use rather than for resale." Thus, the total proceeds from the sale of electricity to consumers, which include all costs of transmission and distribution, are subject to sales tax. In this case, however, the Department seeks to pyramid the sales and use tax by also imposing use tax on the cost of equipment used in two of the integrated phases through which electricity is provided to consumers: transmission and distribution. This is an improper attempt to impose multiple levels of sales and use tax on the cost of providing electricity that is ultimately sold to consumers at retail. In addition, in the context of a public utility, the impropriety of this type of multiple, pass-through taxation is exacerbated because the tax costs compound and flow through to increase costs imposed on consumers. Many other states have specific statutory provisions that address sales and use taxation of electricity and public utility purchases. The application of these provisions are state-specific and vary depending on the specific statutory terms of the provisions in each state. However, one similarity in the statutory provisions in various states is the function of the exemption or exclusion, which, as the Supreme Court of Pennsylvania has recognized, is to reduce the burden on the public.[12]

If this Court were to accept the Department's arguments, the costs of equipment used in providing electricity to consumers in a final form that is safe, reliable, and usable, would be subject to use tax, which would in turn increase the total retail price of electricity. This would result in the consumers' payment of an increased amount of sales tax because sales tax would be imposed on the amounts of use tax paid on inputs (i.e., transmission equipment) that are absolutely necessary to provide electricity in a safe and usable form. This would be an improper

[12]*Commonwealth v Public Constructors, Inc,* 432 Pa 589; 248 A2d 29 (1968) (noting that the purpose for an exclusion from use tax for a public utility "obviously [is] to save the public utilities, and thus the public, the cost of the use tax"), rev'd by *City of Phila. v Commonwealth,* 569 Pa. 381; 803 A.2d (holding that the exclusion for public utilities does not require property to be used exclusively for public purposes).

pyramiding of tax, which is exactly the result that the industrial processing exemption was enacted to prevent.

D. The Pyramiding of Tax Created by the Department's Position, Which Is Contrary to the Plain Language of the Controlling Statutes, Would Result in a Regressive Tax that Would Harm People and Businesses at the Lowest Income Levels.

The plain language of the controlling statutory provisions is further supported by policy considerations in this case. It is undisputed that pyramiding of sales and use tax increases costs. Moreover, the undue increases in the cost of electricity advocated by the Department in this case would directly affect Michigan residents and businesses, whose electricity bills would increase without a corresponding increase in usage. The impact of sales and use tax pyramiding in this case would act as a regressive tax because the impact would be greatest on, and most harmful to, consumers at the lowest income levels. Black's Law Dictionary defines a "regressive tax" as:

> (1893) A tax structured so that the effective tax rate decreases as the tax base increases. With this type of tax, the percentage of income paid in taxes decreases as the taxpayer's income increases. A flat tax (such as the typical sales tax) is usually considered regressive – despite its constant rate – because it is more burdensome for low-income taxpayers than high-income taxpayers. A growing exemption also produces a regressive tax effect. Cf. *progressive tax; flat tax.*

Black's Law Dictionary 1597 (9th ed. 2009).

In modern society, electricity is not a luxury; rather, it is a basic need. Electricity is used, among other things, to provide for basic light, heat, running water (in the case of a well), and hot water. Electricity is needed to power furnaces, water heaters, stoves, refrigerators, air conditioners, telephones, and electronics. If the Department is allowed to pyramid sales and use taxes on the cost of electricity, this pyramiding will increase electricity bills and place financial stress on citizens. The total sales and use tax burden will increase as a percentage of household income, which will result in a regressive tax that harms consumers at the lowest income levels. The industrial processing exemption in this instance was not designed, and does not operate, to

benefit a business or increase profits; instead, the industrial processing exemption in this case operates to facilitate the provision of safe, usable electricity to Michigan citizens without imposing multiple sales and use taxes on its cost. This pyramiding of sales and use tax on sales of electricity again is precisely the kind of unjustified double taxation that the industrial processing exemption was enacted to prevent.

CONCLUSION AND RELIEF REQUESTED

For the reasons stated above, ITC*Transmission* asks this Court to affirm the decision of the Court of Appeals that the property used by Detroit Edison in the transmission and distribution phases of the integrated electric system are used in industrial processing and entitled to an exemption from sales and use tax.

Respectfully submitted,
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